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HON. BRIAN D. LYNCH
Chapter 11
Location: Telephonic/Courtroom I
Hearing Date: April 11, 2018
Hearing Time: 10:00AM
Response Due: April 4, 2018

11 UNITED STATES BANKRUPTCY COURT
12 WESTERN DISTRICT OF WASHINGTON
AT TACOMA

13 In Re:

14 OLYMPIA OFFICE LLC; WA PORTFOLIO
15 LLC; MARINERS PORTFOLIO LLC; and
SEAHAWK PORTFOLIO LLC

16 Debtors.
17

Chapter 11
CASE NO. 17-44721-BDL-Lead Case
(*Jointly Consolidated*)

DEBTORS' OPPOSITION TO
RECEIVER'S MOTION TO APPROVE
LEASES AND AUTHORIZE USE OF
CASH COLLATERAL

18 **I. INTRODUCTION**

19 Debtors¹ generally support signing long-term leases and obtaining higher lease rates for
20 the properties at issue. Debtors do not support, however, expensive tenant improvements if
21 there is not enough money to pay property taxes. Also, Debtors are concerned about the large
22 tenant improvement expenditure for the proposed leases as compared to the increase in per
23 square foot price. Further, Debtors are concerned about the substantial fees JSH Properties Inc.

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25 ¹ Olympia Office, LLC, WA Portfolio, LLC, Mariners Portfolio, LLC and Seahawk Portfolio, LLC

1 (“JSH”) proposes to pay itself as a result of these leases. In the New York bankruptcy, JSH
2 agreed and the Court approved a reduced fee structure. JSH has ignored that fee structure in
3 the current motion, despite this Court’s order allowing JSH to remain receiver which
4 specifically “ORDERED the Debtors, Noteholder and Receiver [to] endeavor to negotiate with
5 input from the Office of the United States Trustee arrangements similar in substance” to the fee
6 structure approved by the New York Court. *See* Dkt. # 128. If the parties are unable to
7 negotiate the proper fee structure before the April 11th hearing date, the Court should modify
8 the proposed order to allow the proper fees.

9 Recent emails from MLMT suggest JSH may not have sufficient funds to pay the
10 property taxes given the current proposed expenditures.² This is concerning and surprising.
11 This Court’s Order (Dkt. #128, page 10 at ¶3.3.4) requires JSH pay property taxes. As of
12 February 28, 2018, JSH currently holds in excess of \$2,272,564.13 in cash (likely increased by
13 over \$250,000 since the filing of its declaration). The current proposal requires a cash outlay
14 of \$1,817,199, inclusive of substantial lease commissions and construction commissions for
15 JSH. In addition, the 2018 Operating budget provided to debtors a few weeks ago reflect
16 timely payment of property taxes in April 2018.³

17 Below, debtors discuss proposals that will substantially reduce the initial pressure on
18 the cash held by JSH as well as preserve the value of the properties. Further, JSH has
19 presented no evidence the proposed leases must be entered into immediately to preserve
20 tenants (one tenant has two years remaining on its lease term). Before a final decision is made,
21 Debtors request more information (consistent with the type of information required by the New
22 York Bankruptcy Court) and more time to evaluate the prudence of the substantial cash outlay
23 being proposed (Debtors want to make sure property taxes can be paid!). Debtors agree with
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25 ² Ex. A, Declaration of Shawn Rediger (“Rediger Decl.”)

³ Ex. B, Rediger Decl.

1 JSH the proposed transactions are outside the ordinary course of business,⁴ and they deserve
2 more scrutiny in light of the significant expenses proposed and the potential cash flow issues
3 raised by MLMT.

4 **II. BACKGROUND**

5 On or about May 19, 2016, JSH was appointed as a custodial receiver in King County
6 Superior Court, and stayed in that position pursuant to the parties' agreement and various
7 stipulations and orders entered in the United States Bankruptcy Court for the Eastern District of
8 New York, (Cause Nos.16-74892 (lead case), 16-75515, 16-75516, 16-75517) (the "NY
9 Bankruptcy").

10 On December 29, 2017, Debtors moved to remove JSH based in part on its inaccurate
11 projections, and exorbitant fees. Dkt. #18. On January 24, 2018, MLMT filed a cross-motion
12 to retain JSH. The parties negotiated a stipulation and order which was entered on March 23,
13 2018. Dkt. #128. In that stipulation the parties are ordered to:

14 [N]egotiate with input from the Office of the United States Trustee
15 arrangements similar in substance to the following attached stipulations and
16 orders entered in the United States Bankruptcy Court for the Eastern District of
17 New York (Case No. 16-74892, jointly administered)...

18 These negotiations expressly included:

19 [M]odification of the Receiver's compensation, reporting to be provided by the
20 Receiver to Noteholder and Debtors, and access to information to be provided
21 by Receiver to Noteholder and Debtors.

22 Indeed, the parties are negotiating the reduction of the substantial fees proposed to be
23 paid to JSH by operation of approval of these very leases. It is these fees and construction
24 costs that substantially deplete the cash held by JSH which require a closer look, and given that
25 the parties are negotiating the issue, it would be premature to approve the fees charged by JSH.
It is important that Debtors and this Court understand what the total capital commitment JSH

⁴ JSH seeks entry of an order under 11 U.S.C. §§363(b)(1) and 363(c)(2)(Dkt. #118).

1 proposes to make for all the properties in order to evaluate how these proposals fit within that
2 budget. Obviously these expenses impact the cash on hand and the useable cash position. JSH
3 should not undertake expenditures if there is not enough money to pay the property taxes as
4 they come due- and certainly before JSH is paid (as discussed below, MLMT previously
5 agreed to pay the Receiver's fees if there are not sufficient funds).

6 **III. AUTHORITY AND ARGUMENT**

7 **A. General Concerns**

8 Property taxes to be paid on April 30, 2018 total \$217,000. According to the
9 Declaration of Ernie Velton JSH holds \$2,272,564.13 in cash as of February 28, 2018. Dkt.
10 #120, at ¶5. Under the stipulated order, JSH must pay the operating expenses, including taxes.
11 Dkt. #128, Ex A. at ¶3.3.4. No pending motions before this Court demonstrate how those
12 funds will be depleted sufficiently to make payment of property taxes an issue. However, in
13 correspondence MLMT has represented that based on "leasing and construction related costs"
14 there might be "liquidity issues" without any further elaboration or explanation.⁵ If there is a
15 shortfall for some reason by April 30, 2018, the stipulated order provides that JSH's fees
16 should be paid by MLMT. Dkt. #128, Ex A., page 10 at ¶3.4.3. JSH's fees for the present
17 proposals before this Court total \$267,539. Dkt. #120, at pp. 5-8. Therefore, even if all of the
18 proposed costs were incurred up front, if MLMT pays JSH's fees as required by the order there
19 will be ample funds for JSH to make the required property tax payment due April 30, 2018.

20 Debtors do take issue with the size of the fees sought by JSH and understood MLMT to
21 have similar concerns, given that the parties are currently "endeavoring to negotiate. . .
22 arrangements similar in substance" to what was approved in the NY bankruptcy. For example,
23 JSH agreed to reduce construction fees from a blanket 5% of hard costs to "instances where
24 complex construction is necessary and the Debtors and Noteholder both approve the

25 ⁵ Ex. A, Rediger Decl.

1 construction and the Construction Management Fee, in writing.” See Dkt. #128, Ex. 2 at ¶3.
2 Debtors submit that approval of leases containing the current fee provisions is premature and
3 causes unnecessary and substantial depletion to the cash on hand. Instead, Debtors reasonably
4 request that JSH provide an itemized list of all fees it has paid itself since May 2016, including
5 the amount, the nature of the transaction, and the party with whom JSH contracted. Debtors
6 should be permitted to examine JSH’s transaction history to determine how the cash generated
7 by the properties has been used in order to fully assess the necessity of the proposed lease
8 extensions that stand to deplete the remaining accrued income generated by the properties.

9 **B. The Specific Leases at Issue**⁶

10 1. 805 South Mission Street, Wenatchee, Washington

11 Debtors’ appraisals in the record demonstrate this property was worth \$4,700,000 in
12 January 2017. Dkt. #60, at Ex. I. The proposed capital expenses of \$1,317,414 are almost
13 30% of the value of the entire building. Debtors’ appraisal has the highest value for this
14 property of any of the ones before this Court. The appraisal submitted by Midland Loan
15 Services and relied on by this Court values the building (with 100% occupancy) at only
16 \$3,600,000. JSH’s proposed investment is substantial. Yet, those expenses are not recouped.

17 Given this investment, the rents proposed are below market. The December 2016
18 appraisal submitted by the Debtors lists comparable rents in the area of \$17 to \$20 per sq. ft.
19 Thus, while the current rent of \$18.5 per sq. ft. was reasonable without the improvements to the
20 building, JSH is proposing to spend approximately 30% of the building’s value with no
21 increase in rent during the first five years of the proposed ten year lease. More reasonable is an
22 increase to market rate for the first five years. The lease should require a rent increase of \$1.50
23 per sq. ft. now to at least offset that expense, as well as an additional \$1.50 per sq. ft. starting in
24 year six. In fact, such an increase is proposed, but only for years six to ten of the lease. And

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⁶ The issues raised are detailed further in the Declaration of Scott Switzer filed concurrently.

1 before it is realized the landlord must again spend hundreds of thousands of dollars in
2 additional tenant improvements – negating the value of the rent increase. In total the lease
3 proposes spending over \$1.6 million for \$212,872 in increased rent which is not even realized
4 until years six through ten.

5 There is no evidence in the record that JSH attempted to offer less in tenant
6 improvement expenses, nor any evidence that the price per square foot was negotiated. No
7 prior leases This warrants examination because as proposed there is no increase in value of the
8 building due to the new lease, as it is currently occupied, and a prospective buyer may consider
9 deducting the proposed capital expenses from the present value when calculating their offer.
10 Finally, as the leases to the state agencies are cancellable, it would be reasonable to pro-rate the
11 broker commission to a monthly fee, rather than paying and depleting cash at the outset.

12 Debtors propose (1) an increase in rent starting in year 1 of \$1.50 per sq. ft., (2) JSH
13 provide detail about the negotiations, including whether less TIs were offered, (3) JSH provide
14 further detail about the proposed capital expenditures, (4) the \$96,738 broker commission be
15 adjusted to a monthly pro-rata fee, and (5) the construction management fee be suspended until
16 the parties agree on an adjusted rate and basis as contemplated in Dkt. #128.

17 2. 640 Woodland Square Loop, Lacey, Washington

18 Debtors believe this is a good lease and a fair exchange for the proposed improvements.
19 The terms require \$339,000 in expenditures to obtain \$266,400 per year in rents. Therefore the
20 outlay results in \$1,332,004.00 over five years in rent. Further, the lease increases the value of
21 the building by approximately \$4,000,000.⁷

22 Still, since the proposed leases to the state agencies are cancellable, it would be
23 reasonable to pro-rate the broker commission to a monthly fee, rather than paying and
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⁷ See Declaration of Scott Switzer, at ¶ 5.

1 depleting cash at the outset. Especially if doing so would create a cash crunch which would
2 make it difficult to pay the property taxes as they come due on April 30, 2018.

3 Debtors propose (1) JSH provide further detail about the proposed capital expenditures,
4 (2) the \$101,636 broker commission be adjusted to a monthly pro-rata fee, and (3) the
5 construction management fee be suspended until the parties agree on an adjusted rate and basis
6 as contemplated in Dkt. #128.

7 3. 645 Woodland Square Loop, Lacey, Washington

8 With this lease, JSH proposes to spend \$160,792 for a 30 month extension of the
9 existing term of lease and a rent increase of only \$197 per month totaling \$5700 over 30
10 months. Effectively, this proposed lease extension *costs* \$5,360 per month. No explanation for
11 why these terms need to be accepted now is given. Further, a full ten percent (\$16,873) of the
12 proposed expenditure constitutes commissions for JSH. Finally, the current per square foot
13 rent is only \$17.85 and will only be increased to \$18.25 under the proposed lease, whereas the
14 lease on nearby building 640 Woodland Square Loop is \$19.40 per square foot per year.
15 Finally these terms are significantly worse than those proposed on or about July of 2017.

16 Debtors propose (1) JSH provide detail about the negotiations, including whether less
17 TIs were offered, and why the deal needs to be completed now, rather than later, (2) JSH provide
18 further detail about the proposed capital expenditures, (3) the \$6,554 broker commission be
19 adjusted to a monthly pro-rata fee, and (4) any construction management fee be suspended
20 until the parties agree on an adjusted rate and basis as contemplated in Dkt. #128.

21 **IV. CONCLUSION**

22 Debtors request the Court direct JSH to provide debtors detail regarding the proposed
23 capital expenditures, substance of the lease negotiations and communications for the proposed
24 leases. In addition, debtors request the court adjust any lease commissions to a monthly pro-
25

1 rata fee. Finally, debtors request that court suspend payment of any construction management
2 fees until the parties complete negotiations as directed by the order allowing JSH to remain
3 receiver (Dkt. #128).

4 DATED this 4th day of April, 2018.

5 /s/ Shawn B. Rediger

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APPROVE LEASES AND AUTHORIZE USE OF CASH
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DATED this 4th day of April, 2018.

DEBTORS' OPPOSITION TO RECEIVER'S MOTION TO
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